Important Tax Information About Thrift Savings Plan Death Benefit Payments

Death benefits paid from the accounts of deceased TSP participants are taxable income for Federal income tax purposes in the year in which the payment is made. The person receiving the payment is responsible for paying the tax.

We are required by law to provide you with this tax notice, which summarizes tax rules applicable to Thrift Savings Plan (TSP) payments made following a participant's death. Because tax rules are complex, however, you may wish to consult a tax advisor before you make any decision.

1. Tax Withholding

The Federal income tax withholding and rollover rules for TSP death benefit payments depend upon whether the payment is made to the surviving spouse or to someone other than the surviving spouse.

Tax Withholding on Death Benefit Payments Made to Surviving Spouses

A death benefit payment to a surviving spouse is considered an **eligible rollover distribution**. The following tax withholding rules apply:

- There is mandatory tax withholding of 20% on all eligible rollover distributions of $200 or more paid in a single year. The 20% is tax withholding, not actual tax due; therefore, when the surviving spouse files an annual Federal income tax return, he or she may be entitled to a refund of a portion of this amount, or may be required to pay an additional amount.
- A surviving spouse can avoid the 20% withholding on all or any portion of an eligible rollover distribution by asking the TSP to transfer that amount to an Individual Retirement Account (IRA) (other than a "Roth" IRA).[1] However, the recipient **cannot** avoid the 20% withholding on any amount that he or she elects to receive directly, even if the payment is then rolled over to an IRA. *(See Section 2 of this notice.)*
- A surviving spouse may elect to have an amount withheld in addition to the 20% withholding by completing Line 3 of Internal Revenue Service (IRS) Form W-4P, Withholding Certificate for Pension or Annuity Payments. The recipient should submit this form to the TSP Service Office at the address provided at the end of this notice. Line 1 and Line 2 are not valid elections for this type of payment.
- There is no mandatory withholding if the total death benefit payment to the surviving spouse is less than $200. However, the recipient can still elect withholding for a death benefit payment of less than $200 by completing Line 3 of Form W-4P.

Tax Withholding on Death Benefit Payments Made to Persons Other Than Surviving Spouses

A death benefit payment to a person who is *not* the surviving spouse of the deceased participant is treated as a **non-periodic payment** for Federal income tax withholding purposes.

The TSP will withhold 10% for Federal income tax from the payment, unless the TSP Service Office receives from the recipient IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments.

If you submit IRS Form W-4P, you may elect:

- to have no Federal income tax withheld, by completing Line 1 of Form W-4P; or
- to have an amount withheld in addition to the 10%, by completing Line 3 of Form W-4P.

Line 2 of Form W-4P is not a valid election for this type of payment.

Special Note for Beneficiaries of Nonresident Aliens

Special tax withholding rules apply to TSP payments made to beneficiaries of nonresident aliens.

[1] A transfer may also be made to an individual retirement annuity (other than an endowment contract), as discussed in section 402(c)(9) of the Internal Revenue Code. The Individual Retirement Account (IRA) or individual retirement annuity to which your account is transferred must be a trust established inside the United States (i.e., the 50 States and the District of Columbia).

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For a detailed explanation of how these rules apply to you, please read the TSP tax notice "Tax Treatment of Thrift Savings Plan Payments to Nonresident Aliens and Their Beneficiaries." You can obtain a copy of the notice from the TSP Web site (www.tsp.gov) or by calling or writing the TSP Service Office.

A **nonresident alien** is an individual who is neither a U.S. citizen nor a resident alien in the United States.[2] A **resident alien** is a non-citizen who is or was a lawful permanent resident of the United States during any part of a calendar year. An alien may also be considered a U.S. resident if the individual meets the IRS "substantial presence" test for a calendar year.[3] For information on residency status and the tests for residency, you may obtain IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*, or IRS Publication 519, *U.S. Tax Guide for Aliens*.

Other Tax Withholding Information

If you do not have enough Federal income tax withheld from your payment, you may be responsible for paying estimated tax. You may also incur penalties under the IRS estimated tax rules if your withholding and estimated tax payments are not sufficient.

If you elected to have no taxes withheld (by submitting IRS Form W-4P) and you decide before the payment is made that you do want taxes withheld, you may revoke your prior decision by completing another Form W-4P and writing "Revoked" on Line 1 of the form. Taxes will then be withheld at the rate set by law.

You can request additional withholding by completing Line 3 of IRS Form W-4P. If you complete Line 3 of IRS Form W-4P and the total amount of the withholding equals or exceeds the amount of your payment, your entire payment will be withheld.

The TSP does not withhold for state, city, county, or other local income tax. Therefore, you should consult your tax advisor or relevant state or local taxing authorities regarding any potential tax obligations to them.

[2] The "United States" includes the 50 States and the District of Columbia.

[3] This is commonly referred to as the "green card" test.

2. Transferring or Rolling Over a TSP Payment Made to a Surviving Spouse

If you are a surviving spouse receiving a TSP death benefit payment, all or any part of your payment can either be transferred or rolled over to an IRA (other than a "Roth" IRA). This permits you to postpone paying tax on that amount until you withdraw the money from the IRA.

A **transfer** occurs when you instruct the TSP to send all or part of your payment directly to an IRA, instead of issuing it to you. Mandatory 20% Federal income tax withholding does not apply to an amount that the TSP transfers directly to an IRA; **however, it does apply to any payment made to you, even if you then roll it over.**

A **rollover** occurs when the TSP makes a distribution to you (which includes the amount of the payment you receive plus the amount of tax withheld) and you deposit any part of that distribution into an IRA within 60 days of the date you receive it.

In deciding whether to choose a transfer or a rollover, you should consider the following:

- You must pay Federal income tax on any part of the payment that you do not transfer or roll over.
- Because all eligible rollover distributions of $200 or more made directly to you are subject to mandatory 20% withholding, you must pay Federal income tax on the amount withheld for taxes — even if you roll over the amount you receive — unless you deposit personal funds into your IRA equal to the amount withheld. (If you do this, you may receive a refund of the taxes withheld, but you cannot wait until you receive a refund of the withheld amount to complete a rollover.)

Therefore, if you do not want to use personal funds to make up the withheld amount, you should choose to have the TSP transfer the death benefit payment to your IRA directly, instead of rolling it over to your IRA yourself.

If you are not the surviving spouse of the deceased participant, you cannot transfer or roll over your TSP death benefit payment.

3. Tax Reporting

The TSP will report to the IRS all death benefit payments, including all amounts transferred to IRAs by the TSP at the request of surviving spouses. We will also report TSP payments and transfers to the state in which our records show the beneficiary resided at the time the payments were made, if that state imposes an income tax.

In January of the year that follows a TSP payment, the TSP will send you Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. **You should keep the TSP Service Office informed of any changes in your address until this tax information is sent to you.**

You should include the amount reported on Form 1099-R as income on your individual income tax return for the year in which payment was made. However, recipients who are surviving spouses should then exclude from adjusted gross income on the return any amounts that were transferred or rolled over. Attach a copy of Form 1099-R to your Federal tax return.

The TSP must provide the correct Taxpayer Identification Number (TIN) to the IRS on Form 1099-R. In the case of payments to individual beneficiaries, the beneficiaries' Social Security numbers will be used. For payments to a trust or estate, an executor, administrator, or trustee must furnish to the TSP a TIN for the trust or estate before payment will be made to that entity. An individual who applies to the TSP for a payment under a state's small estate procedure must also furnish a TIN for the estate. Thus, a TIN must be furnished for a trust or estate, even though there may be no need to file IRS Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

4. Ten-Year Tax Option

If the payment you receive from the TSP qualifies as an **eligible lump sum distribution**, you may be able to lower the income tax you pay by using the **10-year tax option**.

An **eligible lump sum distribution** is one in which the participant's total TSP account balance is distributed within one tax year (the calendar year, for most taxpayers), regardless of whether this occurs in one or more payments to a single beneficiary or to multiple beneficiaries. With the **10-year tax option**, your eligible lump sum distribution is taxed as if it were paid to you over 10 tax years.

The following rules apply to the 10-year tax option:

- The 10-year tax option is available only if the participant was age 50 before January 1, 1986.
- You must use the 10-year tax option for all eligible lump sum distributions that you receive as a beneficiary of the participant in the same tax year.
- You must use the tax rates in effect in 1986.
- If you transfer or roll over all or any part of your distribution, you cannot use the 10-year tax option.

You can elect the 10-year tax option by filing IRS Form 4972, Tax on Lump Sum Distributions, with your annual income tax return.

5. TSP Service Office Information

If you have any questions regarding this notice, please contact the TSP Service Office at (504) 255-6000 (TDD: (504) 255-5113), or write to:

TSP Service Office
National Finance Center
P.O. Box 61500
New Orleans, LA 70161-1500

If contacting the Service Office in writing, include both your name and Social Security number and the name and Social Security number of the deceased TSP participant. The Social Security numbers are important in identifying the TSP account to which the payment relates.